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The weight of "good faith" on the result of contacts in Common Law, Continental Codes and international system of jurisprudence

There is no single definition of "good faith". It means different things in different contexts and refers to "honesty", "fair dealing" and "reasonableness", which moderate unethical conduct. There is also a distinction between subjective and objective "bona fides"[1]. Subjective "good faith" is related to knowledge of facts or events, or absence of it[2]. "Honesty" refers to a subjective state of mind, while "fair dealing" to an objective state of affairs[3].

Easier to define is "bad faith". In most cases, "bad faith" can occur when one party, without reasonable justification, acts in a manner where the result would be to substantially invalidate the benefit or objective contracted by the other or to cause significant harm to the other, contrary to original purpose of the parties.[4]

The origin of "good faith" in law of contracts gives Roman law, where a court was enabled to take into account the circumstances of fairness. "Bona fides" in Roman law was based on an ethical concept that was applied in the form of rules, like "pacta sunt servanta" [5] and "rebus sic stantibus"[6]. After the fall of Roman Empire, the concept of "good faith" appeared in the eleventh century in mercantile practice in "lex mercatoria"[7] and in eighteenth century was adopted by the Continental Codes. In op-

1 Latin – "Good faith".

2 The concept of subjective "bona fides" in Polish law is mostly related to property law and possession. Art 172 -176 of Polish Civil Code are giving protection of "bona fides" possessor, and moreover to the purchaser of goods from a seller without title while denying it to the acquirer in "bad faith."

3 MacQueen, H., *Good faith in Scots Law of contract: an undisclosed principle?*, in AD.M Forte(ed), *Good faith in Contract and Property Law*, Hart Publishing, Oxford, 1999, p.5.

4 Tetley, W., *Good faith in contract, particularly in the contract of arbitration and chartering* (2004) 35 JMLC 561.

5 "Pacta sunt servanta" (Latin - "pacts must be respected"). This rule refers to private contracts, stressing that contained pacts and clauses are law between the parties, and implies that non-fulfilment of respective obligations is a breach of the contract. However in some cases, like for example in Article 475 of Polish Civil Code (impossibility of performance) and Article 491 of Polish Civil Code (the general statutory provisions concerning delay), this rule is also limited.

6 "Clausula rebus sic stantibus" (Latin –"things thus standing") is the limitation of the rule "pacta sunt servanta". "Rebus sic stantibus" is a doctrine which stands for the proposition that a treaty may become inapplicable owing to a fundamental change of circumstances. It only relates to changed circumstances that were never contemplated by the parties.

7 Latin – "Law merchant". This law had international character and was administered by merchants in special courts with speedy and informal procedures and gave merchants the capacity to control their own affairs. - Keily, Troy, *Good faith & Vienna Convention on Contracts for the International Sale of Goods*, (1999) 1 Vindobona Journal 15.

posite in Common Law system, despite the influence of Lord Mansfield,8 the common law position at that time witnessed the rise of legal positivism[9], the pursuit of legal certainty and the concept of absolute freedom of contract[10].

"Good faith" principle is one of the mains in civilian law system and the law protects it in many different ways. Thus the result of many legal acts depends on this principle. Article 72 (2) of Polish Civil Code (CC) states that the party, who entered or continued into negotiation under breach of good customs, in particular with no will to conclude the agreement, is obligated to repair the damage suffered by the other party[11]. Thus Polish law protects the party from the dishonest behaviour. The Polish Civil Code also states that if one party discloses during the negotiations information under reserve of confidentiality, the other party is obliged not to reveal the information to third parties and not to use it to own purposes. The sanction in this case is the reparation of damages[12]. Therefore under Polish law the parties must conduct the negotiations fairly and in "good faith". In opposite, the common law does not create the obligation to act fair during the negotiations. The parties look after its own interest and are no obligated to the other party of not telling lies (misrepresentation), practising deception (fraud) or using force and fear to coerce the party to enter into the contract[13]. That kind of circumstances in the continental legal system have no right to exist during the negotiation and are the cause to invalid agreement and also obligates the party to repair the damages suffered by the other party[14]. The common law only in very thin way protects in negotiations the weak party by the institution of delictual liability[15], of which example can be the negligent misrepresentation[16].

In the *Walker v Milne*[17], Scots case the key point was the question when it is contrary to "good faith" to break off a pre-contractual relationship. Thus the negotiations were essentially complete. The court's award of damages was based upon what in Continental system is known as the "negative interest"[18] and it seen like the concept of "culpa in contrahendo"[19]. However the Scots doctrine of law always claims that the decision in this case is an exception and does not give rise to a general rule of law; by insinuation that the universal rule is no pre-contractual liability. The comment according to "good faith" in Scots law of contract negotiations appeared very late, in 1995, which was connected

8 British XVIII century jurist. He adopted the guiding principle of "good faith", which demanded an adherence to moral obligation.

9 The school of taught in the philosophy of law which states that there is no necessary connection between the validity conditions of law and ethic or morality.

10 Tetley, W., *Good faith*, *op. cit*. footnote no. 4.

11 Polish Civil Code (Dz. U. 16.05.1964 with later changes).

12 Article 72^1 (1) and (2) of Polish Civil Code.

13 MacQueen, H., *Good faith...*, *op. cit*., footnote no. 3.

14 Article 56 – 65 of Polish Civil Code.

15 Delictual liability. The concept of civil law, which most commonly means the „civil wilful wrong". In common law system is recognized as tort. There can be also distinguished the „quasi-delict", which is an unintentional wrong (*negligence* in common law system).

16 MacQueen, H., *Good faith...*, *op. cit.*, footnote no. 3.

17 (1823) 2 S 379.

18 "Negative interest" (reliance damages) – i.e. the amount of useless costs, but not comprising the "positive interest", i.e. missed profits to be expected.

19 Latin – „culpable conduct during contract negotiations". The doctrine developed to improve the duty of care upon persons who were no yet bound by the contract.

with the harmonisation of European Contract Law. [20] Before, however, the principle of "bona fides" and "fair dealing" was treated as a general rule of law; however its existence was not clearly defined until now[21].

Article 2:301 of Principles of European Contract Law (PECL[22]) states that the party, which has negotiated or broken off negotiation in "mala fides" is responsible for the losses caused to the other party. Bad faith in this case means for examples the lack of real intention to reach an agreement with the other party[23]. Thus this article cerates the obligation to negotiate in good faith and states the sanction to the party with commit "culpa in contrahendo." However the Article does not specify the kind of responsibility of the party. Thus the official commentary states that the legislator has on mind the responsibility not only for "damnum emergens,"[24] like the Polish one[25], but also the party is liable for "lucrum cessans"[26]. According to PECEL, the parties during the negotiations are also obligated to disclosure information to the second party under the sanction of avoiding any resultant contract[27].

The Article 2.1.15 of the UNIDROIT Principles states that there is the freedom of negotiations and the party is not liable for failure to reach an agreement[28]. Nevertheless a party which negotiates in "bad faith" is responsible for loses causes to the other party[29]. The Principles does not specify the meaning of "loses". Is that means the "damage suffered by the other party who expected the agreement to be concluded"[30]? Does "loses" include the lost expectation? Article 7.4.2 of the UNIDROIT Principles states that the harm in the event of non-performance includes loses suffered by the party and *the gain* of which it was deprived[31]. Thus the expectations in Article 2.1.1 would count only as gains and not as losses, because, if so, then it would be specified as it is in Article 7.4.2.

20 MacQueen, H., *Good faith...*, *op. cit.*, footnote no.3.

21 MacQueen, H., Zimmermann, R., *European Contract Law. Scots and South African Perspectives*, Edinburgh, Edinburgh University Press, 2006.

22 The Principles of European Contract Law prepared by the Commission on European Contract Law (1999 text in English). Those principles may form a part of future European civil code.

23 The Principles of European Contract Law (1999).

24 Latin – "actual loss". The harm consist of the lost suffered, loss occurring.

25 Article 415, 471 and others - Polish Civil Code.

26 Latin – "lost profit". The gain lost, profit ceasing.

27 "A party may avoid a contract when it has been led to conclude it by the other party's fraudulent representation, whether by words or conduct, of fraudulent non-disclosure of any information which in accordance with good faith and fair dealing it should have disclosed." - Article 4:107 of the Principles of European Contract Law .

28 UNIDROIT Principles of International Commercial Contracts, 2004. the are the result of the quest for codifying the "lex mercatoria". They become alternative to national contract laws in international disputes, as well as they have been accepted as model for reforming national laws. – Stefan Vogenauer, *Commentary on the UNIDROIT Principles of International Commercial Contracts (2004)*, Aug. 2008.

29 UNIDROIT Principles of International Commercial Contracts, 2004.

30 That is the sanction in the same situation under Polish Civil Code (Article 72 (2)).

31 "The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which is suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm. Such harm may be non-performance and includes, for instance physical suffering or emotional distress". - UNIDROIT Principles of International Commercial Contracts, 2004.

The requirements of "good faith" and fair dealing are the borders of the principle of "libertas contrahendi"[32], which appears in the Article 1:102 of the PECL[33]. Article 1:201 says: "Each party must act in accordance with good faith and fair dealing." And also "the parties may not exclude of limit this duty"[34]. Thus the PECL states that the need to promote "good faith" is listed first and is ahead to the principle of legal certainty[35]. Mr MacQueen claims that Article 1:201 refers to "good faith" in objective standard and arguments it by the fact that the legislator refers in this article also to „fair dealing", which means „observance of fairness in fact which is an objective test".

The concept of "good faith" can also mainly be found in the Article 1.7 of UNIDROIT, which obliges each party to act in accordance with "good faith" and fear dealing in international trade. The parties may not exclude or limit this duty[36].

Furthermore, the principle of "bona fides" lays at the roots of many other legal institutions, like for example the general rule of law "pacta sunt servanta". However, article 79(1) of the United Nations Convention on Contracts for the International Sale of Goods[37], provides for exoneration for non-performance in the event of a *change the circumstances*[38] and thus stands *in contrario*[39] to the rule "pacta sunt servanta". Nevertheless, Mr. Goldman comments this matter by the motto: "if it were generally accepted – one could add the limitation of «pacta sunt servanta» principles by an implicit clause of «rebus sic stantibus» (things thus standing)"[40]. Thus the theory of changing the circumstances ("rebus sic stantibus" in other words) is not in opposition to the principle that "pacts must be respected"[41], because it only limits this principle, creates its borders. Consequently can be said that "bona fide" is the base of those principles and thus the base of those relations. Thus in the case of when the performance of the contract becomes excessively onerous because of the change of the circumstance, the parties are

32 Latin – "the freedom of contract". Is the idea that individuals should be free to bargain among themselves the terms of their own contracts, without governing interference. This basic rule of Polish law of obligation creates Article 353^1 of Polish Civil Code. Therefore, the parties entering into an agreement may shape their legal relationship at their discretion, however provided that its content is not in conflict with the nature of the relationship, the law or the principle of social co-existence. Consequently the sanction in this case when the party not worn those rules is very strict – the agreement is invalid. – The Polish Civil Code.

33 "Parties are free to enter into a contract and to determine its contents, subject to the requirements of good faith and fair dealing, and the mandatory rules established by these Principles". - The Principles of European Contract Law prepared by the Commission on European Contract Law (1999 text in English).

34 *Ibidem*.

35 "The principle of legal certainty" relates to the conceptual scale for weighing up and balancing between formal justice and material fairness in courts decisions. – J. Raitio, *The Principles of Legal Certainty in EC Law*, July 31, 2003, Springer.

36 MacQueen, H., Zimmermann, R., *European Contract Law...*, *op. cit.,* footnote no.22.

37 United Nations Convention on Contracts for the International Sale of Goods, 1980 (CISG), also called Vienna Convention. This is a treaty offering uniform international sales law. However this Convention does not include the reference to good faith as one of the mains principles of contract formation and performance. The CISG refers only to this principle in the interpretation of the Convention.

38 "A party is not liable for failure to perform any of his obligation if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences". – Vienna Convention, 1980.

39 Latin – "In opposition".

40 Guillemard, S., *A comparative stud y of the UNIDROIT Principles and the Principles of European Contracts and some dispositions of the CISG, Kluwer Law International*, May 23, 1999, p. 83.

41 "Pacta sunt servanta".

bound to enter into negotiations with the purpose to end the contract or adopt it in order to distribute between the parties the loses and gains resulting from the change the circumstances with the regard to fear dealing and "good faith"[42].

The term stemming from the intention of the parties, purpose of the contract as well as "good faith" may be implied to the agreement[43]. However the party may avoid that term when it has not been individually negotiated and have causes a significant imbalance in the parties` rights, contrary to the requirements of "good faith" and fair dealing44. This remedy cannot be excluded or restricted[45]. Nevertheless the remedies for mistake, incorrect information, non-performance may be excluded or restricted unless it would not be contrary to "bona fides"[46].

The Article 7.1.6 of the UNIDROIT Principles states that with limits a party's liability for non-performance or permits the party to tender the different performance may not be invoked if it would be grossly unfair to do so in the comparison with the purpose of the agreement[47]. Thus the Principle protects the parties from unfair clauses in the contract.

The Consumer Contracts Directive 199348 states that the contractual term, with has not been individually negotiated have to be regarded as unfair in the case when in the contrary to "good faith" that name causes a significant imbalance between the parties[49]. Thus the directive in that way also protects the weaker (the consumer) part of the contract.

Instruments of European Law are giving vast range of protection of "good faith", fair dealing and fairness. "Good faith" liability in the Anglo-American Law system is not nearly as extensive as those in Continental Law and its existence in contract law is one of the major divisions between those systems of law. The continental law jurisdiction states that "good faith" had to be applied to formation of contract and its performance. More marrow is common law system, with creates this obligation only to the performance of agreement. From the other side the Article 2:301 of the Principles of European Contract Law creates the exception from the general *freedom of contracts* and implements the "culpa in contarahendo" liability (obligations in negotiation). PECEL seek to maintain a balance between the contracting attitudes and concept of civil and common law in the process of harmonization. They are the product of compromise among law and embrace the concept of universal "lex mercatoria". However the question "have we reached the state where "leges mercatoriae"[50] complements the self-supporting international order?"[51] still stays open. Thus PECEL is only exemplar for Polish, English and any other legislator, not the rule of law. The mentioned articles, basically Article 1:102 and 1:201 of

42 Article 6:111 of the Principles of European Contract Law (1999).
43 "In addition to the express terms, a contract may contain terms which stem from the intention of the parties, the nature and purposes of the contract, and good faith and fair dealing" - Article 6:102 of the Principles of European Contract Law (1999).
44 Article 4:110 of The Principles of European Contract Law (1999).
45 Article 4:118 (1) of The Principles of European Contract Law.
46 Article 4:118 (2) and 8:109 of The Principles of European Contract Law
47 UNIDROIT Principles of International Commercial Contracts, 2004.
48 Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, O. J. L. 95, 21.4.1993.
49 Article 3 of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, O. J. L. 95, 21.4.1993.
50 "Leges mercatoriae" (basis from "lex mercatoria") – Latin (Laws Merchant).
51 I mean: "Have we reached the state to implement one international law system?"

PECL prove that this act contains the general duty of fair dealing in contract law. However some comments argue that this solution would undermine commercial certainty, because the application of this rule may be random. "Good faith" seems to be predicated as intuitive sense of justice and have basic meaning in quality and functioning of market relations, however there is also the danger because it can lapse into generality and can become unpredictable. Thus it has to be created stricter border in this aspect of soft law.

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